

estimates are derived using formulas found in standard textbooks on sampling theory.<sup>64</sup> The only issue raised by the RBOCs is that the estimator used by the auditors is not mathematically unbiased, but they quickly come to the conclusion that any bias is negligible.<sup>65</sup> This is confirmed by Dr. Bell, who notes that the magnitude of the bias should be small, and there is no evidence to suggest that it should be in a particular direction.<sup>66</sup>

The Bell Affidavit also concludes that, while the auditors may have slightly underestimated the 95 percent confidence interval, the difference is minimal: the corrected confidence interval would be approximately 6 to 14 percent larger than the values shown in the audit reports.<sup>67</sup> A slightly wider confidence interval would provide absolutely no reason to reconsider the audit reports' conclusions.

Moreover, Dr. Bell notes that a properly-calculated lower bound to the 95 percent confidence interval may actually be above the value shown in the audit reports.<sup>68</sup> Given that the variance of the cost of the missing equipment would grow with the value of the estimate, the proper confidence intervals may be asymmetric, rather than the asymmetric confidence intervals assumed in the audit reports. The lower bound of the confidence

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<sup>64</sup>Bell Affidavit at ¶ 27.

<sup>65</sup>Bell Atlantic Response, Appendix A, at 11.

<sup>66</sup>Bell Affidavit at ¶ 27.

<sup>67</sup>Id. at ¶ 31.

<sup>68</sup>Id. at ¶¶ 32-34.

interval would then be closer to the point estimate, and could well be above the value shown in the audit reports.

The actual statistical analysis that the RBOCs have provided in their responses to the audit reports reduces to the same two conclusions discussed above: (1) the point estimates shown in the audit reports are calculated correctly; and (2) the confidence intervals shown in the audit reports are slightly underestimated. The rest of the discussion in the RBOCs' statistical appendices amounts to the irrelevant observations that (1) the estimates would be more favorable to the RBOCs if they were based on more favorable, hypothetical, scores;<sup>69</sup> and (2) the confidence interval would be wider if a more stringent (99 percent) confidence level were used.<sup>70</sup>

Obviously, the audits' conclusions should be based on actual, not hypothetical, scores. Equally obviously, a 99 percent confidence interval is inappropriate: statisticians typically use confidence intervals between 90 percent and 95 percent.<sup>71</sup> The Commission is no exception; in fact, the Commission recently used a 90 percent confidence interval in an investigation of ILEC compliance with its Part 69 rules.<sup>72</sup> The Commission found that a 90 percent confidence interval "permit[ed] the LECs a

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<sup>69</sup>Ameritech Response, Appendix A-5, at 3.

<sup>70</sup>Bell Atlantic Response, Exhibit 2, at 4; BellSouth Response, Exhibit 1, at 3-4.

<sup>71</sup>Bell Affidavit at ¶ 38.

<sup>72</sup>1997 Annual Access Tariff Filings, Memorandum Opinion and Order, CC Docket No. 97-149, rel. December 1, 1997, at ¶47 (1997 Annual Access Filing Investigation Order); 1997 Annual Access Tariff Filings, Memorandum Opinion and Order, rel. March 31, 1998, at ¶¶13-14.

reasonable margin for error” but “protect[ed] ratepayers and IXC’s from the danger that a higher confidence interval would fail to detect” rule violations.<sup>73</sup> The Commission also noted that the use of a 90 percent confidence interval was consistent with the fact that the burden of proof rested on the LECs.<sup>74</sup> The same considerations support the use of a 95 percent or even 90 percent confidence interval in this proceeding, to the extent that the confidence interval is relevant to the Commission’s evaluation of the RBOC CPR audits.

#### **V. “Undetailed Investment” Must Be Considered Missing**

The investment that is shown in the RBOCs’ PICS/DCPR systems as “undetailed” is properly considered “missing”. During the field audits, none of the RBOCs was able to demonstrate that assets associated with the undetailed investment exist and are used and useful in the provision of telecommunications service. The RBOCs were not even able to provide documentation for the acquisition of these assets, despite being given numerous opportunities over a period of months. Of the six RBOCs that the auditors asked to provide cost support, three provided no cost support at all<sup>75</sup> and the other three provided cost support that was completely unconvincing.<sup>76</sup>

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<sup>73</sup>1997 Annual Access Filing Investigation Order at ¶ 47.

<sup>74</sup>Id.

<sup>75</sup>See SWBT, U S West, and Pacific audit reports.

<sup>76</sup>See Ameritech, Bell Atlantic North, and BellSouth audit reports.

**A. The RBOCs Offer No Explanation for Undetailed Investment from Recent Vintages**

The RBOCs contend that “undetailed” investment is associated with hard-wired COE that was placed prior to the implementation of AT&T’s mechanized property record system, PICS/DCPR, beginning in the late 1960s.<sup>77</sup> The RBOCs point to the original 1968 PICS/DCPR specification, which called for older hard-wired equipment to be recorded with a designation of “040000” or “undetailed.”<sup>78</sup> According to this specification, only hard-wired COE placed after the conversion to PICS/DCPR would be “detailed.”

The RBOCs’ explanation fails to account for the presence on the RBOCs’ books of undetailed investment from vintages after the implementation of PICS/DCPR. Table 2, below, shows that up to 97 percent of the RBOCs’ undetailed investment is associated with vintages after the RBOC’s implementation of PICS/DCPR. Moreover, the amount of “post-PICS/DCPR implementation” undetailed investment was even higher prior to the Bureau’s 1994 CPR audits.<sup>79</sup>

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<sup>77</sup>See, e.g., SBC Response at 34-40.

<sup>78</sup>Id. at 36.

<sup>79</sup>See, e.g., SBC Response at 31, n. 65.

**Table 2 -- Distribution of RBOC Undetailed Investment**  
**(Source: Audit Reports, Section V.A)**

Company	PICS/DCPR Implementation Year	Total Undetailed Investment	Undetailed Invest. post-implementation	Percentage post-implementation
Ameritech	1975-82	\$261 million	\$100 million	38 percent
BA-North	1973	\$377 million	\$366 million	97 percent
BellSouth	1973	\$139 million	\$105 million	76 percent
Pacific	1968	\$28 million	N/A	N/A
SWBT	1983	\$924 million	\$1 million	1 percent
U S West	1977	\$219 million	\$100 million	46 percent

The presence of such large amounts of “undetailed” investment from vintages after the implementation of PICS/DCPR is not only contrary to the property record plan approved by the Commission in 1968, but is contrary to the Commission’s Part 32 property record rules. The RBOCs do not even attempt to explain why “undetailed investment” from vintages after the implementation of PICS/DCPR should not be considered in violation of the Commission’s rules.

**B. Pre-PICS/DCPR Hard-wired COE is not Exempt from the Commission’s Property Record Rules**

With respect to the vintages pre-dating the implementation of PICS/DCPR, the RBOCs suggest that the Commission somehow exempted this equipment from the Part 31 (and now Part 32) property record rules. For example, SBC argues that “[t]he FCC has known about the undetailed investment for many years, at least since 1968, and yet,

the FCC has never taken the position until now that the existence of the undetailed investment that pre-dated the mechanized property record system (e.g., PICS/DCPR) would constitute a violation of the FCC's rules . . . .”<sup>80</sup>

The RBOCs' characterization of the Commission's 1967/1968 correspondence with AT&T as effectively waiving the application of the Part 31 property record rules to older hard-wired equipment is without merit. These property record rules had been in effect for many years prior to AT&T's introduction of PICS/DCPR. Nothing in the Commission's correspondence with AT&T about PICS/DCPR suggests that the assets placed before the implementation of PICS/DCPR were viewed as exempt from the basic property record rules and continuing property rules. In fact, at the same time that AT&T informed the Commission that older hard-wired equipment would not be “detailed” in PICS/DCPR, AT&T committed to maintaining its older manual property record system for the equipment shown as “undetailed” in PICS/DCPR. In addition, AT&T never requested a waiver of the Part 31 rules for the equipment that would be shown as “undetailed.” Among other things,

- The Commission did not waive Section 31, Appendix B(5), which required companies to maintain property records in such a manner that “the property can be readily spot-checked for proof of physical existence.”<sup>81</sup> Section

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<sup>80</sup>SBC Response at 34.

<sup>81</sup>47 C.F.R. § 31, Appendix B(5) (1968).

31, Appendix B(5) was retained in substantially similar form as Section 32.2000(f)(5).

- The Commission did not waive Section 31.01-2(a), which required the detail records supporting account entries to be “readily accessible for examination by representatives of this Commission.”<sup>82</sup> Section 31.01-2(a) was retained in substantially similar form as Section 32.12(b).
- The Commission did not waive Section 31, Appendix B(8), which required that “[a]ll drawings, computations, and other detailed records which support either the quantities or the costs included in the continuing property record shall be retained as a part of or in support of the continuing property record.”<sup>83</sup> Section 31, Appendix B(8) was retained in substantially similar form as Section 32.2000(f)(8).

Thus, the Commission’s 1968 correspondence with AT&T cannot be construed as waiving the Part 32 property record rules for any vintage of assets shown as “undetailed investment” in PICS/DCPR, even undetailed investment that pre-dates the implementation of PICS/DCPR. To the extent that undetailed investment from older vintages is in fact associated with hard-wired equipment placed prior to the

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<sup>82</sup>47 C.F.R. § 31.01-2(a) (1968).

<sup>83</sup>47 C.F.R. § 31, Appendix B(8) (1968).

implementation of PICS/DCPR -- which the RBOCs have not been able to demonstrate -  
- the RBOCs must be able to demonstrate the physical existence of this equipment.

**C. Undetailed Investment Must be Considered Missing**

The undetailed investment must be considered missing. While the RBOCs seek to assure the Commission that assets associated with this equipment exist and are used and useful, the audit results make it impossible for the Commission to accept these assurances. During the audits, none of the RBOCs was able to demonstrate that assets associated with this investment were ever acquired or placed in service, much less demonstrate that assets associated with this investment are used and useful in the provision of telecommunications service.

Even if some of the undetailed investment line items were associated with hard-wired COE placed prior to the introduction of PICS/DCPR -- which the RBOCs have not been able to demonstrate -- it is highly unlikely that these assets are still used and useful in the provision of telecommunications service. At a minimum, the presence of large amounts of undetailed investment from very old vintages demonstrates that the RBOCs have failed to record retirements of this equipment as it was taken out of service.

**D. The Commission Should Investigate the RBOCs' Unexplained post-1994 Audit Adjustments to their Undetailed Investment Balances**

Whenever regulators have scrutinized the RBOCs' undetailed investment, the RBOCs' pattern has been to assure the regulator that undetailed investment is associated



with assets used and useful in the provision of telecommunications service -- but the regulatory scrutiny has always led to substantial reductions in undetailed investment balances.

For example, when a 1992 D.C. PSC staff investigation questioned undetailed investment in Bell Atlantic - D.C.'s circuit equipment accounts, Bell Atlantic assured the D.C. PSC that this investment was associated with real assets. However, after the D.C. PSC required a joint staff-Bell Atlantic working group to investigate the undetailed investment, "the working group indentified a substantial amount of investment that was inappropriately recorded in Account 2232."<sup>84</sup> The subsequent removal of the undetailed investment from Bell Atlantic-DC's books resulted in "major reductions in depreciation expense."<sup>85</sup>

After the 1994 preliminary audits by the Commission's Audits Branch raised similar questions about the RBOCs' undetailed investment, the RBOCs assured the audit staff that this equipment did exist -- and then suddenly began to remove significant amounts of undetailed investment from their books. Table 3 below shows the significant reductions in RBOC undetailed investment balances after the 1994 audits.

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<sup>84</sup>Chesapeake & Potomac Telephone Company, Formal Case No. 926, Order No. 10353, 148 P.U.R. 4th 113, 187 (1993).

<sup>85</sup>Id.

**Table 3 -- Post-1994 Audit Reductions in Undetailed Investment**

Company	Reduced from:	on:	Reduced to:	on:	Source:
Ameritech	\$555 million	12/31/93	\$261 million	7/97	response, p. 9
BA-N	N/A				
BA-S	\$344 million	12/31/93	\$1.8 million	3/31/97	report, n. 42
BellSouth	N/A				
Pacific	\$182 million	1994	\$27 million	1997	response, p.33
SWBT	\$1.47 billion	5/93	\$923 million	3/31/97	response, p.20
U S West	N/A				

The RBOCs contend that they reduced their undetailed investment balances by “detailing or retirement.”<sup>86</sup> But there is no evidence to suggest that the RBOCs have been able to find, and then detail, much of this equipment. The vast majority of the undetailed investment was likely removed from the books through accounting retirements.<sup>87</sup> These post-1994 audit accounting retirements should be viewed as an admission that much, if not all, of the undetailed investment shown on the RBOCs’ books at the time of the 1994 audits was not associated with used and useful assets.

In the Bell Atlantic-South audit report, the Bureau auditors note that they plan to ask Bell Atlantic to explain how it accomplished the “significant” decrease in its undetailed investment after the 1994 audits, from \$344 million at the end of 1994 to \$1.8

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<sup>86</sup>See, e.g., SBC Response at 18; Bell Atlantic Response at 18.

<sup>87</sup>See U S West Response, Attachment 3. Of the 25 “undetailed” CPR line items for which the Bureau auditors requested cost support, U S West “retired” 21 items.

million in 1997.<sup>88</sup> The auditors should make similar requests of the other RBOCs, and investigate whether the accounting treatment of the RBOCs' recent reductions to their undetailed balances has been appropriate.

## **VI. Customers Have Been Harmed, and Continue to be Harmed, by the RBOCs' Overstatement of Investment**

The RBOCs are overcharging their customers by hundreds of millions of dollars per year as a result of the COE plant balance overstatements. The inflated plant balances have inflated both their current revenue requirement and their revenue requirements in prior years. These inflated revenue requirements have translated directly into customer overcharges, both in the jurisdictions that have continued to use rate of return regulation and in the jurisdictions that have adopted price cap regulation.

### **A. The Overstated Investment Has Inflated the Rate Base**

When investment for which there are no associated used and useful assets is added to an RBOC's books, the RBOC's revenue requirement is inflated. The source of the overstated revenue requirement is two-fold: (1) the RBOC's rate base is initially overstated by the phantom plant investment amount, and will remain overstated until full "recovery" of the phantom investment is achieved; and (2) the RBOC's depreciation expense is overstated.<sup>89</sup>

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<sup>88</sup>Bell Atlantic Audit Report at ¶27 n. 42.

<sup>89</sup>Snively King Majoros O'Connor & Lee, Inc., "Report on the Impact of Missing Plant on ILEC Revenue Requirements," September 23, 1999, at 6 (Snively King Report).

Recognizing that newly-added investment for which there are no associated used and useful assets inflates both the rate base and depreciation expense, the RBOCs argue that the missing plant consists “only” of omitted retirements.<sup>90</sup> As the RBOCs are quick to point out, omitted retirements do not generally result in a rate base overstatement, since the effect of a retirement is to reduce both gross plant and the depreciation reserve by the amount of the retirement.

As convenient as the omitted retirement claim may be for the RBOCs, the audit reports make clear that the RBOCs cannot substantiate this claim. None of the RBOCs has been able to provide sufficient and convincing documentation for the acquisition of the assets in question and for their placement into regulated accounts,<sup>91</sup> despite the fact that the Commission’s rules require such documentation to be maintained.<sup>92</sup>

Because the burden is on the RBOCs’ to demonstrate that the “missing” equipment was placed in service, and the RBOCs have been unable to make this showing, the Commission must assume that the missing investment was not associated with assets actually placed in service. As a consequence, the RBOCs’ revenue requirements have been overstated both by an inflated rate base and by inflated depreciation expense.

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See Attachment 2.

<sup>90</sup>See, e.g., BellSouth response at 3.

<sup>91</sup>Bell Atlantic North Audit Report at ¶¶ 26, 30, 38.

<sup>92</sup>47 C.F.R. §§ 32.2000(e)(2)(iv), 32.2000(f)(5), and 32.2000(f)(8).

## **B. Even “Omitted Retirements” Inflate RBOC Revenue Requirements**

Even if were true that part of the missing investment represents “only” omitted retirements, this missing investment would still have inflated RBOC revenue requirements. Omitted retirements inflate gross plant, and thus inflate the depreciation expense component of RBOC revenue requirements.

There is no merit to the RBOC claim that the effects of the inflated gross plant would have been offset by a lower depreciation rate. As is discussed in the attached Snavelly King Report (Attachment 2), the depreciation rate would have been the same had omitted retirements been recorded properly by the RBOCs.<sup>93</sup> Ironically, Bell Atlantic’s depreciation expert, Dr. Ronald E. White, comes to the same conclusion, stating that “[i]t is a near certainty that posting these retirements when the plant was physically removed from service would not have changed past depreciation rates.”<sup>94</sup>

The RBOC argument that depreciation rates would have been higher rests on the incorrect assumption that the remaining life component of the depreciation rate formula would have been the same had retirements been recorded properly.<sup>95</sup> If the remaining life had been the same, as the RBOCs assume, the lower depreciation reserve percentage that would have resulted from the correct processing of retirements could have translated into a higher depreciation rate.

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<sup>93</sup>Snavelly King Report at 8-9.

<sup>94</sup>Bell Atlantic Response, Exhibit 5, p. 7 (¶24).

<sup>95</sup>Ameritech Response at 13.

However, as is demonstrated by the Snavely King Report, the remaining life would have been longer if retirements had been processed properly.<sup>96</sup> A longer remaining life would have offset the effects of the reduced depreciation reserve percentage, resulting in RBOC depreciation rates generally the same as those that were actually used.

The Snavely King Report's conclusion that the remaining life would have been longer had retirements been processed properly is based on the fact that omitted retirements are generally found among the older vintages.<sup>97</sup> If the RBOCs were in fact omitting retirements, they would have been inflating the investment in the older vintages and thus depressing the remaining life used by the Commission in represcription proceedings. Without the extra investment in the older vintages caused by omitted retirements, i.e., had retirements been processed properly, the remaining life would have been longer.

Omitted retirements are generally found among the older vintages because plant tends to be removed from service toward the end of its expected life, not at the beginning.<sup>98</sup> Given that more plant is being retired from the older vintages, and assuming that the failure to retire plant is a random occurrence, omitted retirements are more likely to occur among the older vintages.

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<sup>96</sup>Snavely King Report at 8.

<sup>97</sup>Snavely King Report at 11.

<sup>98</sup>Id.

In the White Affidavit attached to Bell Atlantic's audit response, the claim is made that the missing Bell Atlantic equipment is "uniformly" distributed across the vintages and, thus, that the remaining life was unaffected.<sup>99</sup> To the extent that it is true that the missing Bell Atlantic equipment is uniformly distributed across the vintages, then this would further undercut Bell Atlantic's claim that the missing equipment is due solely to omitted retirements. Given that few retirements are attempted among newer vintages, the presence of a significant number of missing equipment items from recent vintages cannot be explained as the result of omitted retirements. Missing equipment from recent vintages would be almost certain to represent equipment that was never placed at all, and thus has inflated the rate base and inflated depreciation expense.

**C. Inflated Revenue Requirements Have Inflated the RBOCs' Interstate and Intrastate Rates**

The RBOCs argue that the audits serve no purpose because, they contend, interstate rates are no longer set with reference to costs.<sup>100</sup> However, price cap-regulated companies must still charge rates that are just and reasonable. And, as Chairman Kennard has written, whether rates are set pursuant to price caps or rate of return or some other method, the reasonableness of rates presumes that the underlying costs are used as one of the factors in determining their overall level.<sup>101</sup>

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<sup>99</sup>Bell Atlantic Response, Exhibit 5, p. 7.

<sup>100</sup>See, e.g., SBC Response at 47.

<sup>101</sup>Letter from William E. Kennard, FCC to Hon. Thomas J. Bliley, Jr., September 8, 1998, at 4.

The RBOCs' overstatement of their plant account balances has translated directly into inflated interstate rates. Overstated plant balances inflated the costs that the RBOCs used to develop their projected 1990-91 revenue requirements, which were the basis for the July 1, 1990 rates used to initialize the price cap regime. The inflated July 1, 1990 rates have caused every subsequent price cap index (PCI), including the current PCIs, to be inflated as well.

Predictably, the RBOCs argue that the audits cannot be used to draw conclusions about the initial price cap rates.<sup>102</sup> But the audit reports demonstrate that the RBOCs CPR problems are longstanding, and that these problems are unlikely to have accelerated in recent years.<sup>103</sup> The reports note that the large number of incorrect CPR line items discovered by the 1997 audits could not have been generated overnight, and that undetailed investment, in particular, has been a serious problem for many years. In fact, the RBOCs emphasize that their undetailed investment balances, as high as they are today, were even higher before the Bureau's 1994 audits.<sup>104</sup>

The RBOCs' overstatement of their COE plant balances has inflated intrastate rates as well. As Commissioner Rolka of the Pennsylvania PUC noted, "[t]he states could have three-quarters of this problem."<sup>105</sup> In fact, the states were instrumental in the

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<sup>102</sup>See, e.g., Bell Atlantic Response at 16.

<sup>103</sup>Bell Atlantic Audit Report at ¶¶ 33-35.

<sup>104</sup>See, e.g., SBC Response at 20.

<sup>105</sup>"FCC Audit Cites Bells' Lost Items; Finding Could Spur Push for Rate Cuts," *Washington Post*, August 13, 1998, p. E1.



Commission's decision to conduct the CPR audits.<sup>106</sup> Based on concerns raised by various state commission staff in the early 1990s that local exchange carriers may not be maintaining their CPRs, NARUC adopted a resolution in 1993 that encouraged the Commission to perform CPR audits.<sup>107</sup> For those states that have continued to use rate of return regulation, inflated RBOC revenue requirements translate directly into inflated rates. In the states that have adopted price cap regulation, the longstanding RBOC CPR deficiencies inflated rates by distorting the rates used to initialize the states' price cap plans.

## **VII. The Commission Should Take Immediate Enforcement Action**

The audit reports demonstrate (1) that the RBOCs have violated, and continue to violate, the Commission's Part 32 accounting rules; and (2) that the COE investment shown on the RBOCs' books has been overstated and continues to be overstated.

The Commission should immediately initiate enforcement proceedings against the RBOCs based on the audit reports' findings. First, the Commission should require the RBOCs to make downward adjustments to their PCIs to remove the effects of plant overstatements from RBOC interstate rates on a going-forward basis. Absent such

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<sup>106</sup>Kennard Letter to Congress, p. 3.

<sup>107</sup>Id.

action, the RBOCs' PCIs would remain inflated indefinitely, regardless of any measures taken to correct the plant balances shown in the RBOCs' accounts.<sup>108</sup>

There is no merit to Bell Atlantic's claim that the LEC Price Cap Order somehow prevents the Commission from requiring such PCI adjustments. In characterizing the initial price cap rates as "the best that rate of return regulation can produce," the Commission was simply deciding that the benefits of a general rate case did not justify a delay in adopting price cap regulation.<sup>109</sup> Nothing in the LEC Price Cap Order forecloses later adjustments to correct for misstatements of the initial price cap rates. In fact, the Commission has in the past proposed PCI reductions to correct for ILEC accounting rule violations that inflated the initial price cap rates.<sup>110</sup>

Second, the Commission should require the RBOCs to write off the missing investment from their COE accounts and bring their internal processes into compliance with the Commission's accounting rules, as is recommended by the audit reports.<sup>111</sup> As the Commission has observed, the Commission's ability to carry out its obligation to ensure that rates are just and reasonable is impaired if the Commission cannot rely on the

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<sup>108</sup>The Bell Atlantic Telephone Companies, Order to Show Cause, 10 FCC Rcd 5099, 5102 (1995) (Bell Atlantic Order to Show Cause).

<sup>109</sup>Policy and Rules Concerning Rates for Dominant Carriers, Second Report and Order, 5 FCC Rcd 6786, 6816 (1990).

<sup>110</sup>See, e.g., Bell Atlantic Order to Show Cause, 10 FCC Rcd at 5102. See also The Bell Atlantic Telephone Companies, Consent Decree Order, 11 FCC Rcd 14839, 14840 (1996); The GTE Telephone Companies, Consent Decree Order, 9 FCC Rcd 2594, 2595 (1994);

<sup>111</sup>Bell Atlantic North Audit Report at ¶¶ 42-46.

accounting information reported by carriers.<sup>112</sup> The RBOC audit reports demonstrate that the Commission cannot rely on the plant balances reported by the RBOCs for any purpose.

### **VIII. Conclusion**

The methodology and procedures used by the audit staff were more than reasonable, and fully complied with applicable auditing standards. Accordingly, the audit reports' findings provide the basis for the Commission to take immediate enforcement action against the RBOCs.

Respectfully submitted,  
MCI WORLDCOM, INC.



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September 23, 1999

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<sup>112</sup>Bell Atlantic Order to Show Cause, 10 FCC Rcd at 5099.

### Attachment 1: Total Missing Equipment

Company	Hard-wired COE	Undetailed Investment	NYNEX Inventory	Total	Unallocated Other Costs
Ameritech	\$306.0	\$260.7	\$0.0	\$566.7	\$65.0
Bell Atlantic - North	\$387.6	\$376.7	\$291.0	\$1,055.3	\$419.0
Bell Atlantic - South	\$805.7	\$0.0	\$0.0	\$805.7	\$89.0
BellSouth	\$291.7	\$138.5	\$0.0	\$430.2	\$125.0
Pacific/Nevada	\$499.1	\$27.7	\$0.0	\$526.8	\$87.0
SWBT	\$221.7	\$923.8	\$0.0	\$1,145.5	\$157.0
U S West	\$387.6	\$218.6	\$0.0	\$606.2	\$122.0
<b>Total</b>	<b>\$2,899.4</b>	<b>\$1,946.0</b>	<b>\$291.0</b>	<b>\$5,136.4</b>	<b>\$1,064.0</b>

## **Attachment 2: Snavelly King Report**

**REPORT ON THE IMPACT OF MISSING PLANT  
ON  
ILEC REVENUE REQUIREMENTS**

**PREPARED BY**

**SNAVELY KING MAJOROS O'CONNOR & LEE, INC.**

September 23, 1999

**REPORT ON THE IMPACT OF MISSING PLANT ON ILEC  
REVENUE REQUIREMENTS**

*Prepared By Snavelly King Majoros O'Connor & Lee, Inc.*

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**ATTACHMENTS**

1. Resume of Richard B. Lee
2. Remaining Life Calculation - Direct Weighting
3. Remaining Life Calculation - Reciprocal Weighting

# REPORT ON THE IMPACT OF MISSING PLANT ON ILEC REVENUE REQUIREMENTS

*Prepared By Snavelly King Majoros O'Connor & Lee, Inc.*

## I. INTRODUCTION

This report was prepared by Snavelly King Majoros O'Connor & Lee, Inc. ("Snavelly King") at the request of MCI WorldCom.<sup>1</sup> It examines the impact on incumbent local exchange carrier ("ILEC") revenue requirements of "missing" plant, as discussed in the Commission's Notice of Inquiry ("NOI") relating to Continuing Property Records ("CPR") audits.<sup>2</sup> The NOI is based on audits of ILEC hard-wired central office equipment conducted by the Common Carrier Bureau. The NOI states:

The auditors categorized plant as "missing" when neither the Bureau auditors nor the company personnel accompanying the auditors could find the equipment during the field audits and if, subsequently, the companies were unable to submit documentation to permit the auditors to rescore or modify their prior findings.<sup>3</sup>

Contrary to ILEC contentions, this report concludes that missing plant results in an overstatement of ILEC revenue requirements.

The primary author of this report is Richard B. Lee, Vice President of Snavelly King. Since joining Snavelly King in 1991, Mr. Lee has assisted clients in scores of Commission proceedings

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<sup>1</sup> Snavelly King was founded in 1970 to conduct research on a consulting basis into the rates, revenues, costs and economic performance of regulated firms and industries. Members of the firm have participated in over 500 proceedings before almost all of the state commissions and all Federal commissions that regulate utilities or transportation industries.

<sup>2</sup> Ameritech Corporation Telephone Operating Companies' Continuing Property Records Audit, et al., CC Docket No. 99-117, ASD File No. 99-22, NOI, FCC 99-96, released April 7, 1999, p. 3.

<sup>3</sup> Id., footnote 3.



**REPORT ON THE IMPACT OF MISSING PLANT ON ILEC  
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*Prepared By Snavelly King Majoros O'Connor & Lee, Inc.*

relating to accounting, depreciation and other matters. He also has appeared on behalf of various clients in proceedings before 26 state commissions. Prior to joining Snavelly King, Mr. Lee represented AT&T before the Commission in all financial and accounting matters, including depreciation. Attachment 1 to this report provides Mr. Lee's complete resume.

**II. ILEC ANALYSIS OF THE IMPACT OF  
MISSING PLANT IS INCORRECT**

The ILECs contend that missing plant has little or no effect on their revenue requirements.<sup>4</sup>

They base this counter-intuitive position on three assumptions:

1. CPR records are not used in the development of revenue requirements.<sup>5</sup>
2. Missing plant is due only to delayed retirements. Ameritech states "Any CPR discrepancies are most likely immaterial record-keeping matters and may at most reflect delayed retirements."<sup>6</sup>
3. Delayed retirements do not affect ILEC revenue requirements. Ameritech concludes that "depreciation expense (and consequently revenue requirements)

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<sup>4</sup> See, e.g., Response of Ameritech, pp. 12-14; Bell Atlantic, pp. 14-15; BellSouth, pp. 3-4; SBC, Attachment C, p. 1; U S West, Attachment 1, pp. 8-9.

<sup>5</sup> Response of Bell Atlantic, pp. 13-14.

<sup>6</sup> Response of Ameritech, p. 12.